

## Shelley Seiveking Comments

(Red italicized comments are Sterling's Response. If there is no response from Sterling, the suggested edit was incorporated into the report.)

My comments/suggestions are:

1) My main concern with the draft report is the way it describes the decisions where a recommendation to change was voted down. For example, in the executive summary, on page 4, it sums up the discussion by saying that "The Task Force considered, but did not reach agreement on, recommendations regarding three other areas: central warehousing, uniform pricing, and delivered pricing." In discussion of these and other specific points on which there was a vote that resulted in no recommendation for change, the draft report says that the Task Force "did not adopt a recommendation." (p. 37) A fairer summary would be that: "The consensus of the Task Force was not to recommend change at this time" as to those things where a vote was taken and a proposed change was actually voted down.

*Sterling: We believe there is a difference between agreeing not to recommend change, and voting against a specific recommendation, especially when there was not unlimited time for discussion and many alternative recommendations. Therefore we think it would be misleading to suggest there was consensus not to recommend change – that was not the vote. With that in mind we changed the wording in the executive summary was to: "The Task Force voted against proposed recommendations..."*

This is true in several other areas as well. On page 31, at the top, the report shows the recommendation that price posting be eliminated, but the report fails to mention that a proposal to eliminate the "hold" was defeated twice. Again, probably the most accurate objective description is: "The consensus of the Task Force was not to recommend change at this time".

*Sterling: The "hold" was not defeated twice. There was one vote that included eliminate post and hold with some other provisions that was voted down, which we noted. The second live motion for a recommendation with post only was adopted. We added "...and hold" in the side bullet to include the fact that the hold portion was not recommended for change – though this was by inference (since the motion that only included post passed), not by a specific proclamation of the Task Force. We also made a note to emphasize "price hold was not recommended for change at this time."*

On Page 38-39 it says that a recommendation was not adopted on delivered pricing. Same thing on page 42, at the bottom, with regard to uniform pricing. And I believe also on page 48, for "different rules for LCB retailing" (though I was

not there for this discussion ). It seems all of these should be: "The consensus of the Task Force was not to recommend change at this time" .

*Sterling: We believe there is a difference between agreeing not to recommend change, and voting against a specific recommendation, especially when there was not unlimited time for discussion and many alternative recommendations. Therefore we think it would be misleading to suggest there was consensus not to recommend change – that was not the vote.*

2) I think it would put the Costco litigation in a more proper context, if the first footnote on page 1 of the body of the report listed the provisions at issue in the suit or cross referenced page 56 where this is done. The second footnote needs to be completed. And the third footnote appears to be in the wrong place; as it currently stands, it makes it look as though the WBWWA was granted the right to intervene in the appeal, not at the trial level. They intervened at the trial level.

3) There are several places where alcohol is described inappropriately. The first is on page 9, last paragraph: "However, alcohol is still a controlled substance." This is not accurate and is disparaging to the product. The same description occurs on page 17. Alcohol is a REGULATED product, not a "controlled substance," which has a particular meaning under the law and relates to certain illicit narcotics and illicit drugs. I suggest the following revision: "However, alcohol is still a highly regulated product that can cause harm to people and society if misused."

Comments on Appendix D:

1) On page 9 of Appendix D, the last bullet of the discussion highlights in the Tied House-Ownership section, should be clarified. It was "prevention community representatives," not generic "community representatives" who did not support the liberalization of naming rights regs.

Comments on Appendix E:

1) On page 23, number 76 at the top of the middle column appears out of place; it seems this is a strength, not a weakness, and if so, should be in the right hand column.

## Katie Jacoy Comments

(Red italicized comments are Sterling's response. If there is no response from Sterling, the suggested edit was incorporated into the report.)

Report - Page 1: Needs to be a paragraph that explains the history of the self-distribution portion of the Costco case and the fact that neither party is appealing Judge Pechman's ruling on self-distribution. I suggest the following addition: "On December 21, 2005, the District Court found that Washington statutes that permit in-state beer and wine producers to distribute their products directly to retailers, while withholding such privileges from out-of-state beer and wine producers, discriminate against out-of-state producers in violation of the Commerce Clause of the United States Constitution. The Court ordered remedy was to eliminate the self-distribution privilege from the in-state wineries and breweries; however, the Court stayed the entry of judgment until April 14, 2006 to provide a sufficient period of time for the Washington State Legislature to determine whether to extend the self-distribution privilege to out-of state beer and wine producers instead. The Washington Legislature and Governor chose this option by enacting 2SSB 6823. **Neither the State nor the Washington Beer and Wine Wholesalers Association are appealing this portion of the Costco decision.**"

*Sterling: The next sentence in the document was modified to make it consistent with the addition of this paragraph. It now reads, "The LCB and the Washington Beer and Wine Wholesalers Association have filed an appeal to the remaining issues decided in favor of Costco."*

Report - Page 2: delete "temporarily" in the first paragraph and second bullet. Add the following sentence: "The bill included a sunset date of June 30, 2008 to bring all interested parties back to the table to review the impacts of the legislation."

Report - Page 2 under scope of review: It needs to be clarified that the LCB also sells wine and beer in state stores.

Report - Page 11: If you are going to include employment data for the wholesale tier, you should also include employment data for the WA beer and wine industry.

*Sterling: The distributor data was compiled for the discussion on the compelled use of distributors. We do not have similar employment data for the other two tiers. However, the information was deleted at the request of Phil Wayt on an objection to making such a large distinction between the Association distributors and those who do not belong to the Association.*

Report - Page 14: Delete the following sentence in the first paragraph: "Participants indicate that most manufacturers and retailers are still compelled to use distributors because other regulations make it impractical not to use them, and it is, in fact, an efficient means to move their product." Replace it with: "Participants indicate that

manufacturers and retailers will continue to use distributors, if available, because other regulations make it impractical not to use them, and distributors, if available, remain an efficient means to handle their product. Many small and medium sized wineries are not able to find distributors to handle all or some of their products.”

Report - Page 21 third paragraph: delete “temporarily.” Amend the second sentence in third paragraph to read: “Other regulations such as a prohibition on centralized warehousing and constraints on the use of common carriers, make self-distribution more difficult.”

Report - Page 21 fourth paragraph under interview results, delete the following sentence: “Even without provisions for mandatory use, all but a few very small manufactures indicated they would continue to use distributors.” Replace it with the following: “Even without provisions for mandatory use, manufacturers with distributor relationships indicated they would continue to use distributors.” Clarify the bullet on the side to read: “Most industry participants, with distributor relationships, believe . . .

Report - Page 27 in Background paragraph, amend the second sentence to say: “Some grocery retailers and wine manufacturers would like to have properly controlled wine samplings in grocery stores that are currently prohibited.”

Report - Page 30 in first paragraph: I remember the concept of “price wars” being brought up by the wholesalers, not the state; please clarify if appropriate. This phrase has very negative connotations. I suggest deleting it, or in the alternative adding a sentence to say that “It was noted by one industry participant that in CA and other states without hold requirements, price wars have not been an issue.”

Report - Page 46: Third paragraph under task force Perspectives, amend the first sentence to read: “Some members are concerned the timing may not be good to establish research capacity within the LCB, questioning whether it makes sense to gather data to support a system that may need to change due to the Costco litigation.”

Report - Page 56: Since this review was authorized in 2SSB6823, this page should include a summary paragraph about the self-distribution ruling as well. See my suggested change on Report – Page 1.

If you have any questions about these suggested comments, please do not hesitate to contact me at (253) 952-0368.

## Mary Segawa Comments

(Red italicized comments are Sterling's response. If there is no response from Sterling, the suggested edit was incorporated into the report.)

### Executive Summary

Page 1, First paragraph after SSSB 6823, 3<sup>rd</sup> line

“...comprehensive review of the state's regulatory system. . .” (Add the “y”)

Page 1, Last paragraph:

“Some members support maintaining the current system without change.”

Is this accurate? I don't recall that anyone voted against all changes suggested.

“Some members support maintaining the current system with limited change,” may be more accurate.

*Sterling: This statement refers to general discussions rather than specific votes. At least one person has consistently stated that no change is needed or desired.*

Page 2, Recommendation #1, first paragraph, last line:

“...public health, safety or welfare.” (Add a comma after “health”)

### Report

Page 1, 2<sup>nd</sup> paragraph, first sentence:

“... when Costco Wholesale Corporation filed a lawsuit against the Washington State Liquor Control Board, challenging a number of. . .” (Delete the period after “Board”)

Page 3, final paragraph:

“This report details the work of the Task Force; the process, research. . .” (Replace the semi-colon with a colon. Semi-colons separate independent clauses, and the clause following the semi-colon is not independent.)

Page 4, 1<sup>st</sup> sub-heading:

“Task Force participants – industry stakeholders and legislators.” This omits those of us who are not industry stakeholders or legislators. A solution would be to omit “industry stakeholders and legislators.”

Page 4, 2<sup>nd</sup> sub-heading, 1<sup>st</sup> paragraph, last full line:

“... and to prepare the Task Force report for review and acceptance.” Omit “to.”

Page 7, 2<sup>nd</sup> sub-heading:

“Federal regulations and Washington's alcohol control laws were developed to stem crime and social issues. . .” Control laws don't “stem social issues.” Recommend changing to “...stem crime and address social issues . . .”

Page 7, paragraph following the 2<sup>nd</sup> sub-heading, 2<sup>nd</sup> sentence:

“Federal and Washington state alcohol control laws were developed in the early 1930’s after **the** Prohibition, to address significant issues that occurred. . .” Delete “the” and the comma after “Prohibition.”

Page 8, 2<sup>nd</sup> bullet under second paragraph:

“ . . . practice results in the retailer purchasing less **that** it would have. . . “ Change to “than.”

Page 9, 1<sup>st</sup> paragraph:

“ . . .In addition, **there is** the public is well-educated about the negative impacts of alcohol, as well as studies pointing to the positive attributes of moderate alcohol consumption. . .” Delete “there is.” Also, “ . . .as well as studies” doesn’t flow. Possible change: “\ . . the public is well-educated about the negative impacts of alcohol and knowledgeable about studies pointing to the positive attributes of moderate alcohol consumption.”

Page 9, 3<sup>rd</sup> paragraph:

“While in the past, manufacturers were limited and large. . .” Delete the comma after “past.”

Page 16, 4<sup>th</sup> bullet point:

“ . . .(and some added for trade practices too)” I don’t understand this phrase. No suggestions.

Page 18, 3<sup>rd</sup> paragraph:

**This is a major issue for me.** The overall focus of this paragraph is on economic development. I would like to see a stronger reference to the balancing of public health, safety, and welfare. Suggested wording, beginning with the second sentence: “Although the Task Force did not conclude that economic development should be a policy goal for alcohol regulation, economic impacts (including impacts on public health, safety and welfare), should be considered when evaluating potential changes.” Then continue with the remainder of the paragraph.

Page 18, final paragraph:

Insert a comma between “health” and “safety.”

Page 27, Sampling

I’m a little puzzled about the comment that this was not a high priority for Task Force discussion. It seemed like we did discuss it quite a bit. Just a question for me. . . . Is this because we didn’t actually vote on it?

*Sterling: The item was not rated highly in the Task Force prioritization process.*

Page 28, Naming Rights

Can we add that the prevention field believes naming rights affects “social norming” which in turn encourages underage drinking?

Page 29, last full paragraph:

“. . . and an effective tool. . .” Change to: “. . .and is an effective tool. . .”

Page 32, 1<sup>st</sup> paragraph:

“. . .is not intended to affect other aspects of pricing regulations **such provisions**. . . “  
Insert “as” between such and provisions.

Page 37, 3<sup>rd</sup> paragraph, 1<sup>st</sup> line:

“. . .beer and wine producers, and on. . .” Delete the comma.

Page 37, Product Placement section, 2<sup>nd</sup> paragraph:

“. . .discourage the temptation **by** under-age consumers.” Change “by” to “of.”

Page 46, near bottom of page:

Spacing problem is next to last paragraph.

Page 48, Task Force Perspectives, 4<sup>th</sup> paragraph:

I would add that the state does, however, have other business constraints, such as a ban on advertising, that other retailers do not have.

Page 48, last paragraph (also would need to change the sidebar comment):

“. . . LCB should focus limited resources on preventing. . .” Insert “their” before “limited.”  
Without it, it sounds like they should limit their resources for prevention.

Page 49, 1<sup>st</sup> Task Force Perspective:

“. . .such as ensuring minors are not allowed to purchase alcohol and over-serving of customers at on-premise outlets.” This sentence structure indicates ensuring the over-serving of customers. Alternatives would be “reducing” or eliminating” over-serving of customers. E.g. “. . .ensuring minors are not allowed to purchase alcohol and reducing the over-serving of customers at. . .”

Page 51, final sidebar note:

“It is difficult to assess **an** societal impacts related. . .” Delete “an.”

Pages 54 & 55:

I recommend indicating the vote tallies on these recommendations so they can see at a glance whether they were approved by a large majority or just narrowly.

## Phil Wayt / John Guadnola Comments

(Red italicized comments are Sterling's response. If there is no response from Sterling, the suggested edit was incorporated into the report.)

In any event, here are my suggested edits to the draft report:

1. Executive Summary, page 1: We think you should add a new paragraph immediately following the second paragraph on this page which would read

Some Task Force members expressed concerns about the make-up of the Task Force. The prevention and treatment community believed it was underrepresented. There was some sentiment that employee groups should have been included in the Task Force. The distributors believed that, in light of the large retailer and producer representation, distributors were underrepresented. In addition, some Task Force members expressed frustration with the limited amount of information provided to them in connection with their discussions of specific provisions of the laws. In some cases it appeared that there was not significant information available from other states, **and in other cases it appeared that some information which was available was not given to the Task Force.**

*Sterling: We truncated this in the executive summary, since it's supposed to be brief there – but included the most of the text (**with the exception of the bold above**) in the body of the report.*

*We take exception to the last part of the last sentence (bolded by us), since it implies we withheld information from the Task Force. We faithfully forwarded all documents we received and followed up on sources when they were provided. There were periodic comments at Task Force meetings about the existence of reports and studies...but, although we asked for the information, no one was able to provide that information to us – Do you have specifics about available information that was not given to the Task Force?*

2. Executive Summary, page 1, ¶ 3: We believe the first sentence of this paragraph should be changed to read "Most Task Force members generally agreed that the current system of regulating the distribution and sale of beer and wine could benefit from some changes."
3. Executive Summary, page 1, ¶ 3: We believe the last sentence of this paragraph should be changed to read "Some Task Force members believe



that this approach has resulted in the regulatory system not keeping pace with changes in industry and society that have occurred in the past 70 years."

4. Executive Summary, page 2, first full paragraph: We think you should put a period after "key issues and concerns" in the fourth line of this paragraph, and then add a new sentence that reads "There was not necessarily agreement among Task Force members that all items identified in the interviews were genuine issues, because the significance of the different points raised depends on one's perspective, interest or position within the system." (Note: this language is adapted from page 20, ¶ 1.)

5. Executive Summary, page 2, first full paragraph: We think you should change the balance of this paragraph to read

The Task Force prioritized the various points raised in the interviews in order to focus its efforts on the most significant issues. The issues considered by the Task Force in its final meeting were ranked in descending order of importance (most important to least important) as follows: (1) price posting and hold; (2) need for funding of enforcement efforts; (3) need for ways to measure impacts of the laws, including the change to the direct shipping law adopted in 2006; (4) the general "moneys' worth" prohibition; (5) the ban on quantity discounts; (6) the mandatory minimum markup; (7) mandatory use of distributors (focusing on the use of common carriers in addition to other issues identified separately); (8) uniform pricing; (9) rules governing LCB retailing of beer and wine; (10) the ban on central warehousing; (11) the delivered pricing requirement; and (12) the ban on credit sales to retailers. The Task Force reviewed all of these issues, and considered a restatement of the State's policy goals, in its final meeting.

*Sterling: This was the order that recommendations were discussed at the October 12 meeting, but they were not in any kind of priority order. We listed the items discussed in the executive summary, but did not indicate a specific priority on them. (Also didn't include the reference to the policy goal discussion since we mentioned it in the paragraph before – again trying to keep this at a summary level.)*

6. Executive Summary, page 2, ¶ 2: We believe you should add a new sentence to the end of this paragraph, to read "Four of the recommended changes were adopted unanimously, and the other eleven were adopted on divided votes; four proposed recommendations for changes to the current laws were not adopted."

*Sterling: We added: "Four of the recommended changes were adopted with no opposition (1, 2, 9 and 11); seven were adopted by divided votes." There were votes taken in three additional issue areas that did not pass, which we indicate at the end of the section.*

7. Full Report, page 1, ¶ 2: We find inclusion of the lengthy quote from Judge Pechman's ruling unnecessary and inappropriate. The Task Force decided that its deliberations would not be driven by that decision, so there is no need for anything more than a passing reference to it being one of the impetuses behind the Task Force. Inclusion of the extended quote implies that the Task Force thinks that her ruling was correct, and WBWWA for one certainly does not think that.

8. Full Report, page 1, ¶ 3: We believe the reference to "several years" for disposition of the appeal is incorrect, and that it would be more accurate to say "They believe it will take at least another year, and perhaps much longer depending on how the case unfolds and whether there are further appeals, before the case is finally resolved."

9. Full Report, page 2, ¶ 4: We think the statement in line 7 of this paragraph, "the District court findings would not be final for some time," is inaccurate and misleading; it would be more accurate if it read "The LCB believed it would be some time before the District Court rulings are affirmed or reversed by the Court of Appeals."

*Sterling: Though we don't see any problem with the suggested language, this language is attributed to the LCB and they did not opt to change it in their review, so we don't think it is appropriate for you to change something attributed to the LCB. If they wish to change the wording on this, they may do so.*

10. Full Report, page 4, ¶ 1: We believe that you should add, at the end of this paragraph, a new paragraph that reads

Some Task Force members expressed concerns about the make-up of the Task Force. The prevention and treatment community believed it was underrepresented. There was some sentiment that employee groups should have been included in the Task Force. There was some concern that including small retailers, large retailers, in-state wineries, out-of state wineries, in-state breweries and out-of-state breweries gave the production and retail arms of the industry a disproportionately heavy representation. The distributors believed that, in light of the large retailer and producer representation, distributors were underrepresented. **Some Task Force members believe the make-up of the group skewed the discussions. This concern was exacerbated by the fact that**

**appointed representatives who were unable to attend all the meetings sometimes sent substitutes who were not familiar with all of the discussions. This left those substitutes no choice but to pursue their own economic interests.**

*Sterling: We included the first part of your comments, but **not the bolded part**. This was never discussed at the Task Force – at least not in the open forum of the task force. It would be unfair to include it here.*

11. Full Report, page 5, ¶ 6 (last line of page): We think you should insert a new sentence, before "However," that would read: "Some Task Force members believe the make-up of the group skewed the discussions. This concern was exacerbated by the fact that appointed representatives who were unable to attend all the meetings sometimes sent substitutes who were not familiar with all of the discussions. This left those substitutes no choice but to pursue their own economic interests."

*Sterling: We inserted part of this comment (see 10) in the previous paragraph. This would be repetitious as it follows only 2 paragraphs later, so we did not include it again.*

12. Full Report, page 8, ¶ 4: We think the word "almost" should be deleted from line 3 of this paragraph. Federal laws are aimed solely at manufacturers and distributors. The federal government does not regulate retailers.

13. Full Report, page 9, ¶ 1: I do not understand why the second sentence of this paragraph is included. Since the day Washington's laws were first enacted there have been "rules and regulations for enforceable licensing, to effectively collect taxes, etc." In this sense there has been no change in the environment, and we think it is misleading to imply that there has been. We think the second sentence of the first bullet point in the right-hand margin on this page should also be deleted.

14. Full Report, page 10, ¶ 2: We believe the reference to Section 12 at the end of this paragraph, and Section 12 itself, should be deleted. As mentioned above, the Task Force deliberations have not been constrained or driven by the Costco lawsuit and discussion of the lawsuit in this report is unnecessary and inappropriate.

*Sterling: We will note that you request this section to be deleted, but we are not deleting at this time since at least one legislative task force member had asked specifically that the issues being challenged in the court case be included in the report.*

15. Full Report, page 11, ¶ 6: The reference to "two basic types of distributors" is confusing, and I think it is simply wrong. There are some distributors who belong to WBWWA and some who do not. Some of WBWWA's members are large and some are small; some handle only wine, some handle only beer, and most handle both. All are "independent" companies. All distributors, whether members of WBWWA or not, are governed by the same laws and regulations. We think this paragraph should be rewritten to remove any reference to two types of distributor, and to focus on the distributor tier itself. If you want to include a sentence to the effect that some distributors who are not members of WBWWA have different views on some of the issues considered by the Task Force than do WBWWA members, that would be fine.

*Sterling: We made changes here that I think get to what your issue was.*

16. Full Report, page 14, ¶ 4, second bullet point: We are concerned that this bullet point could be misunderstood. It would be more accurate and less prone to misinterpretation if it read: "Uniform pricing - requires each manufacturer to offer the same price for a particular product to all of its distributors and requires each distributor to offer the same price for a particular product to all of its retailer customers."

17. Full Report, pages 14-15, transition paragraph: While it is correct that retailers do not have a minimum markup requirement, we think it would make sense to add, at the end of the sentence at the top of page 15, a new sentence to read as follows: "Retailers are, however, prohibited from selling beer or wine for less than what they paid for it."

18. Full Report, page 15, ¶ 2: At the end of this paragraph you should consider adding a new sentence that reads: "The state and WBWWA also believe that the ban on central warehousing furthers the state's goals of uniform pricing and a level playing field, preventing larger retailers from obtaining a significant competitive advantage over smaller retailers."

*Sterling: We included this but left out "The state and.." since it is your comment and not the state's.*

19. Full Report, pages 16 and 17: We think that inclusion of the interview results is inappropriate. None of the Task Force members actually heard any of the interview comments, other than those made in a group interview they may have participated in, and inclusion of these recapitulations seems to suggest that the interviews played a much more important role in the Task Force deliberations than was in fact the case. This discussion of the interviews should, we think, be eliminated entirely or moved into an appendix.

*Sterling: We will note this comment, but we are not taking it out at this time. The foundation for the task force discussion of the system strengths and weaknesses was taken from the interview comments, which included all of the task force participants.*

20. Full Report, pages 16-17: If the Task Force elects to keep the discussion of the interviews in the full report, we think there should be an additional comment included at the end of the transition paragraph that goes from page 16 to page 17. At the end of the parenthetical at the top of page 17, please add "Some Task Force members believe that effective control of misuse of alcohol and effective tax collection can only be accomplished if there is state regulation of the transactions between producers or distributors and retailers because that is where the large volume of beer and wine transactions take place."

21. Full Report, page 17, last bullet point: Again, we think this section should be removed. If it remains in the report there should be a new paragraph added to the end of the bullet point, following the parenthetical, that reads: "Other Task Force members think that all aspects of the beer and wine distribution business have the potential to contribute to misuse of alcohol and should not be left unregulated (distributors, some treatment/prevention, some producers and retailers)"

22. Full Report, page 18, ¶ 1: The second sentence of this paragraph says that the basic policy goals "have not been vetted or adopted in any formal way" by the legislature. This is simply wrong. In 1995, when the legislature codified what had been regulations, it included an intent section in RCW 66.28.180 that specifically refers to "the public's interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption." While this does not articulate the goals in as much detail as the Task Force's recommendation, it is still a clear indication that the legislature believes temperance and orderly marketing are critical goals of the regulatory system.

*Sterling: We changed the wording to: "Although these principles have been used by the state, and some portions adopted in RCW language, they have not been formally stated and adopted as policy goals." Hopefully that gets across your general point, since we say the state has used these goals. [But the point is they have never been articulated and adopted together as "policy goals" – and that's why the Task Force addressed them.] If this wording still doesn't work for you, please bring it up at the meeting.*

23. Full Report, generally Sections 7 and 8 (pages 21-43): It seems to me that these sections of the Report devote far more time to interview participants' comments than is appropriate. It makes sense to include the

comments or concerns voiced by interview participants that were also voiced by Task Force members. However, we believe that comments coming solely from the interviews should not be in the report but in an appendix if included at all.

*Sterling: We will note this comment, but we are not taking it out at this time. The foundation for the task force discussion of the system strengths and weaknesses was taken from the interview comments, which included all of the task force participants. The interview comments provided the foundation of the Task Force's work.*

24. Full Report, page 22, ¶ 5: The state's purpose in adopting and maintaining the "moneys' worth" rule is not just to prohibit suppliers from controlling retailers. It is also to prevent retailers from obtaining undue influence or control over distributors or producers. We think the first sentence of this paragraph should be changed by adding the phrase: "and to ensure that retailers cannot control the actions of suppliers or distributors."

*Sterling: We did not add this point (to ensure retailers cannot control the action of suppliers or distributors.) This point was not expressed by the state as a reason for money's worth regulations. If you want to bring this up at the meeting, please do so.*

25. Full Report, page 23, ¶ 3: At the end of this paragraph there is a statement to the effect that the Task Force wants to ensure that enforcement is focused on "critical outcomes." We don't disagree with this in the large sense. However, we strongly believe that the only way to effectively pursue "critical outcomes" is to control all aspects of the business. Consequently, we think there should be an additional sentence added to this paragraph that reads: "Some Task Force members believe that this requires significant enforcement with respect to sales to retailers as well as sales by retailers. The transactions between distributors and retailers or between suppliers and retailers involve large quantities of beer and wine. If control of those transactions fails or is weakened, the state's ability to effectively prevent excessive promotion of beer and wine or to properly enforce drinking age laws will be significantly compromised."

26. Full Report, page 28, ¶ 2: The reference to the Federal Commerce Commission should be to the Federal Trade Commission. We think there should be an additional line added to this paragraph as follows: "At least one Task Force member believes the federal regulations are too limited to effectively accomplish the state's goals."

27. Full Report, page 30, ¶ 1: At the end of this paragraph we think you should add a new sentence: "Others believe the hold simply constrains the ability of distributors and retailers to change prices in response to transitory changes in market conditions in order to increase sales."



28. Full Report, page 30, ¶ 2: We think the discussion of the effects of the price hold is incomplete. We believe you should add, after "price stability" in the 7<sup>th</sup> line of the paragraph, the following: "A price hold is viewed by the state and some Task Force members as essential to meaningful enforcement of the uniform pricing requirement and other aspects of the 'level playing field' the state seeks to preserve."

*Sterling: We include this except left out "by the state" – for reasons previously stated – this is your comment and not the state's comment.*

29. Full Report, page 31, ¶ 1: We believe the last sentence of the description of the minimum markup requirement is inaccurate. We think it would be better if it read: "By mandating a minimum markup the state makes it impossible for suppliers or distributors to sell product at distress prices, which in turn eliminates one potential contributor to over-consumption. The minimum markup is functionally indistinguishable from a ban on sales below cost."

*Sterling: We included the first sentence as a suggested change, but not the second sentence. The LCB made it clear at the last meeting that there is a difference between the minimum mark-up and the ban on sales below costs.*

30. Full Report, page 32, ¶ 5: We think the discussion of volume discounts is incomplete. We think you should add a new sentence to the end of this paragraph as follows: "In addition, some people are concerned that volume discounts to retailers will translate directly into lower prices and excessive promotion on sales to consumers. This could be particularly problematic with respect to on-premise retailers who secure volume discounts from distributors or suppliers."

31. Full Report, page 36, ¶ 6: The discussion about the concerns of Task Force members regarding central warehousing is not complete. We think you should add a new sentence that reads: "Concerns were also expressed that central warehousing would make it harder to enforce restrictions such as the Alcohol Impact Areas. Currently distributors know which retail premises are legally entitled to receive which products; with central warehousing distributors would not know where the products they were delivering to the warehouse would ultimately be sold, and thus would not be able to prevent improper deliveries as they can now do."

32. Full Report, page 38, last ¶: We believe you should add a new sentence to the end of the last paragraph on this page, to read as follows: "Other members believe that any attempt to separate the price of the product from the price of the delivery would make it impossible to maintain uniform pricing because the product price could be manipulated by negotiating differences in the price for delivery services."

33. Full Report, page 39, ¶ 2: Again, we think this discussion is incomplete. We believe you should add a new sentence at the end of this paragraph, that reads: "Other Task Force members think it is unwise to rely on taxes because they are politically difficult to impose and raise, and that raising taxes alone would not further, and might well hinder, some of the state's goals such as uniform pricing."

*Sterling: We incorporated most of the suggested words, but changed the last part to ...hinder, "other state regulations such as uniform pricing." Since uniform pricing is not a state goal.*

34. Full Report, page 40, ¶ 4: This discussion is also incomplete. We think there should be an additional sentence at the end of this paragraph that reads: "They also believe it is necessary to preserve the separation between the tiers. There is a vast difference between a retailer being in debt to a credit card company and a retailer being in debt to a distributor or supplier. The supplier or distributor might try to use that debt to gain undue influence over the retailer. The retailer might attempt to extract favorable credit terms from the supplier or distributor."

*Sterling: We incorporated without the word "vast."*

35. Full Report, page 40, ¶ 5: The phrase "Many of them" in line three of this paragraph is confusing. It would be more accurate, I think, to say "Some Task Force members believe etc."

36. Full Report, page 40, last ¶: This is another instance where the discussion seems incomplete to me. Please consider adding new sentences at the end that read: "These Task Force members believe the ban on credit sales is important to preserving separation of the tiers, is essential to preservation of uniform pricing, and eliminates what would otherwise be a potential for special deals favoring one retailer over another. **They also believe there is a vast difference between a retailer being in debt to a credit card company and a retailer being in debt to a distributor or supplier.**"

*Sterling: We incorporated all but the bolded part since that was just stated in the paragraphs above.*

37. Full Report, page 42, ¶: I believe that "can contribute to alcohol misuse" in this paragraph should be "do contribute to alcohol misuse."

38. Full Report, page 47, ¶ 1: We strongly disagree with the last two sentences of this paragraph, which question whether there is a causal link between the regulations and consumption of alcohol. There is absolutely no doubt that the regulations cause prices to be somewhat higher than they



otherwise would be. There is no doubt that this results in consumption being somewhat lower than it would otherwise be. No reputable economist will disagree with this, because to do so would be to say that the laws of supply and demand don't apply to beer and wine. The problem with the data currently available is that it is impossible to quantify the relationship between any particular regulation and consumption because there are too many other variables impacting consumption. Nonetheless, we do not believe there is any principled way to argue that consumption of beer and wine in Washington is not lower than it would be if the laws did not exist. We think the last two sentences should be deleted and replaced with the following: "The state needs factual, depoliticized data to attempt to determine the extent of the causal link between specific regulations and alcohol consumption."

39. Full Report, page 48, ¶ 2: After "inequitable" in the second line of this paragraph you should add "to some."

40. Full Report, page 49, first full paragraph: For purposes of capturing the complete spirit of the discussions, we believe you should add a new sentence, before the parenthetical, that reads: "Some Task Force members believe that stemming the misuse of alcohol requires enforcement activities directed to transactions between suppliers or distributors and retailers. Those transactions involve large quantities of alcohol, particularly by comparison to consumer transactions, and if they are not properly regulated retailers will have greater opportunity and greater incentives to offer beer and wine at significantly reduced prices or to otherwise promote increased consumption of beer and wine."

*Sterling: We added a short sentence to the end.. "...and controlling transactions between suppliers or distributors and retailers." There is a reference already there to the previous discussion on this topic, so it seems redundant to repeat the same exact comment again.*

41. Full Report, pages 56 and 57: As I mentioned above, we think this entire section should be deleted. It suggests that the court case has much greater significance than it does, and it at least gives the impression that the Task Force agrees with the Judge's legal analysis. We don't agree with it, and fully expect Judge Pechman to be reversed on appeal. Costco undoubtedly feels she will be affirmed. The Task Force, however, probably does not have and in our view should not have an opinion on the matter.

*Sterling: We will note that you request this section to be deleted, but we are not deleting at this time since at least one legislative task force member had asked specifically that the issues being challenged in the court case be included in the report.*

42. Full Report, page 58, ¶ 1: We think the second sentence of this paragraph should be deleted. The Task Force did not vote on whether the state "must" do anything, and there certainly is no unanimity on that point. There is no unanimity as to whether the system needs "modernization," nor as to whether "societal values," business practices or consumer interests have evolved to the point that change is mandatory. Inclusion of this sentence conveys the impression that the Task Force believes wholesale changes are required by today's circumstances, and we do not believe that to be true.

*Sterling: We took out that part of the sentence altogether.*

Hi, Jill.

I'm expecting Phil to send you substantive comments about the report, but I thought it might be helpful if I sent you a list of the typos and technical changes that I think you will want to make before the report becomes final. None of these are significant as far as the meaning of the report goes, so I don't see any reason for you to track them or credit them but I'll leave that up to you.

1. In the third bullet point of the Policy Goals (on page 2 of the Exec Summary) there is a reference to "public sale/consumption of alcohol by legal adults." This seems kind of awkward to me. I know the group voted on it, but I think it would make a lot more sense if it read "legal public sale/consumption of alcohol by adults."
2. I think that, in the last paragraph on page 2 of the Executive Summary, the first line would read a little better if it said "current approach of adopting specific exceptions."
3. On page 1 of the Full Report, ¶ 2, line 3, there are both a period and a comma after Liquor Control Board. The period should be deleted. In the fourth line of this same paragraph there should be a period inserted after "wine" and before footnote 1.
4. Same page, last paragraph: line 2 should say "The district court has granted" and line 4 should say "however, the state has asked the Court of Appeals to extend the stay etc."
5. Same page, footnote 2, should read "prohibiting retailer-to-retailer sales."
6. On page 7, in the second heading and in line 3 of the following paragraph you refer to "the Prohibition." I think it would be better to delete "the" in these two places.

7. In ¶ 2 on page 7 there are two references to "at the time" that I think are confusing. I would recommend changing that part of the paragraph to read "Prior to Prohibition, lack of controls on alcohol sales and distribution had resulted in: coercion and manipulation of politics, the industry and consumers; monopolies; lack of product diversity; little control over who sold what to whom; and no means to effectively tax and collect revenues from the products. At that time, manufacturers had considerable control and influence over the retailers, which was believed to be one of the principal causes of the problems leading to Prohibition. Adoption of Prohibition, of course, brought its own problems, notably organized crime. When Prohibition was repealed, the state wanted to avoid having the pre-Prohibition imbalance between producers and retailers, and its attendant problems, resurface. This was addressed etc."

8. On page 9, in the third from last line of the first paragraph, it now says "In addition, there is the public." I think you should delete "there is." Unless there is some additional point you intended to make.

9. On page 10, in the second bullet point in the right-hand column, "in tact" should be "intact."

10. In the first bullet point on page 13, I think you should add "Retail" before "licenses" at the start of the text. Obviously, product can be moved from a distributor's licensed premises to a retailer's licensed premise. It is only movement from one retailer location to another that is prohibited.

11. On page 25, in line 2, you should capitalize "prohibition."

12. On page 26, in the third paragraph, line 5, "affects" should be "effects."

13. On page 34, in the fourth line of the second paragraph, it appears the word "arrangement" should be deleted so it says "a manufacturer to deliver to a retailer."

14. On page 34, in the first line of the fourth paragraph, "this as key obstacles" should, I think, be changed to "this as an obstacle." Whether or not you agree with deleting the word "key" the word "obstacle" should be singular.

15. On page 46 there is an extra paragraph break that makes what should be the sixth paragraph into two paragraphs.

16. On page 52, in the first line of the first bullet point, you should add "of" between "number" and "endorsements".

Those are all the "technical" changes I've got.



## John McKay Comments

(Red italicized comments are Sterling's response. If there is no response from Sterling, the suggested edit was incorporated into the report.)

p.14 – (see John's comment in PDF document)

*Sterling: We added wording that it is the state's intention that the pricing regulations are **meant** to ensure... The reason for this paragraph is to explain the state's logic as to why this strategy is used, not to prove or disprove the effectiveness of the strategy.*

p.30– (see John's comment in PDF document)

*Sterling: We added the following wording: Other Task Force members believe that any enforcement objective behind price posting could be accomplished by a system that does not, as the current system does, make postings available for viewing by competitors – a viewing that reduces competition and does not enhance any enforcement objective. Further there is no requirement for retailers to post prices, which seems to conflict with the notion that price posting is critical.*

p.31 – (see John's comment in PDF document)

*Sterling: We added the following wording: At least one Task Force participant believes there is no evidence that the minimum mandatory mark-up discourages over-consumption, as reflected in the state's decision to abandon retail mark-up provisions after a 1988 federal court decision, without appeal.*

p.34 – (see John's comment in PDF document)

*Sterling: We added to the end of the paragraph: Others were strongly opposed to this argument, contending that there is no definition of orderly market and therefore it is not possible to show that allowing manufacturers to arrange common carriage to retailers would hurt that market. Those opposed believe there has been no explanation of why it is "orderly" for the manufacturer to arrange common carriage, but "disorderly" for the retailer to arrange it, nor why it is "orderly" for manufacturers to arrange common carriage of their products to distributors (as allowed under current law) but "disorderly" for them to arrange common carriage of their products to retailers.*

*Also added: Some members believe that special licensing is not necessary and will simply create another layer of costly bureaucracy and a further barrier to competition with distributors.*

p.36 – (see John's comment in PDF document)

*Sterling: We added: Other Task Force members believe there is no support for the concern that the state would lose control and there would be an increase in illegal sales. There are already provisions for licensing distribution warehouses, and provisions for licensing point of sale outlets. There is no evidence that central warehousing would result in loss of control any more than those examples. Further, Washington lawmakers did not believe loss of control was a reason to prevent out-of-state wineries from shipping wine directly to Washington*

*citizens by common carrier; there is far less control risk present by retailer warehouses distributing beer and wine to licensed retail locations.*

*We did not include the rest of the argument stated in the comments as none of this was discussed in the Task Force meetings.*



November 9, 2006

Nate Ford  
c/o Sterling Associates, LLP  
4820 Yelm Highway SE, Suite B - PMB 148  
Lacey, WA 98503

Dear Mr. Ford:

We appreciate the work that you and Sterling have done on the draft Task Force Report. Costco Wholesale also appreciated the opportunity to participate in the process. We would like the following noted for the record:

1. The votes of the Task Force understate the need and appetite for change among the constituencies affected by the laws at issue. The LCB selected the specific members of the Task Force (based on general direction from the Legislature), and the LCB has a clear interest in the maintenance of the status quo, which it created and has vigorously defended. The record of the Task Force should indicate how the LCB made the selections.
2. In our letter of July 28, 2006, we requested that there be greater transparency concerning the role of the LCB in directing the work of Sterling. The request was not heeded. We renew that request, seeking that the report of the Task Force contain a full disclosure of the influence that that LCB exercised in the setting of agendas, the formulation of alternatives for consideration, and the drafting or editing of the work of Sterling.
3. In general, the draft report continues the problem of repeating uncritically the assertions of the LCB, without attribution or support. This is a poor approach to policymaking in any event. It is especially inappropriate here given that the only recent forum that involved a critical and unbiased evaluation of the assertions of the LCB (the federal court) found them totally wanting. See our letter of July 28 at page 2.
4. At present, we note the following as illustrative of the defects of the draft report:

Page 14 – “The pricing regulations in this category are meant to ensure beer and wine is not priced so low as to encourage misuse . . . and to promote an orderly market, constraining price competition to ensure small manufacturers and retailers can participate on equal footing with larger competitors.” The record contains no support for this assertion, which was created by the LCB for the purposes of defending the litigation – it finds no antecedent in the administrative record of the LCB or the legislative history of the relevant statutes. This passage should be omitted or augmented to indicate that it has no support in the record of the Task Force.

Page 30 – In noting the purported enforcement purposes behind price posting, the draft report fails to make two critical observations, which should be added: (1) any enforcement objective behind price posting could be accomplished by a system that does not, as the current system does, make postings available for viewing by competitors – a viewing that reduces competition and does not enhance any enforcement objective; and (2) if posting is so critical to the enforcement scheme, why doesn't the LCB require retailers to post prices – the LCB has not explained that in the record of the Task Force. The report notes that “in some states the licensee is required to maintain records for inspection” – Washington is such a state and current law gives the LCB to require licenses to retain any information that is currently reflected in the posting system.

Page 31 – It is implied that the minimum mark-up requirements are intended to discourage “over-consumption.” There is no evidence that this has been the purpose or the effect of the mark-up provisions. Indeed, after Costco challenged the minimum mark-up provision applying to retailers, the LCB abandoned it in 1988 after the federal court found this provision to violate antitrust law – the LCB did not even appeal.

Page 34 – “Allowing manufacturers to use common carriers to deliver their product [to retailers] would be inconsistent with the Task Force’s recommended state policy goal of providing an orderly market.” This observation is deeply flawed and should be omitted. Since there is no intelligent definition of “orderly market” it is not possible to show that allowing manufacturers to arrange common carriage to retailers would hurt that market. No one can explain or has explained why it is “orderly” for the manufacturer to arrange common carriage but “disorderly” for the retailer to arrange it. (The only reason this distinction emerged in 2SSB6823 is because the Legislature did not want to deal with issues still undecided then in the lawsuit, not because of a policy choice to make such an arbitrary distinction.) No has it been explained why it is “orderly” for manufacturers to arrange common carriage of their products to distributors (as allowed under current law) but “disorderly” for them to arrange common carriage of their products to retailers.

The suggestion that there be special licensing for common carriers who move alcohol is a solution without a problem. It simply creates another layer of costly bureaucracy and a further barrier to competition with distributors. The record does not reveal any such special requirements in the federal system or in any other state’s system.

Page 36. The assertion is made that “once the product is delivered to the central warehouse the state would lose control over the movement of the product, increasing the opportunity for illegal sales.” There is no support behind this assertion and it should be omitted. The state currently licenses warehouses – those operated by distributors and bonded warehouses authorized by statute. There is no problem with a “loss of control.” Similarly, multiple retail locations are licensed without a “loss of control” – why is there loss of control when a retailer’s location is used simply for storage as opposed to sales? In fact, history shows that the prohibition against central warehousing was initiated by the distributors and not by the LCB for control purposes. For years, the LCB allowed retailers to warehouse, with no adverse effects. In 1942, it



authorized retailers to have an "additional storage facility away from [their] licensed premise[s]" and for wholesalers to "make deliveries of beer and/or wine to the specified additional storage facility." In 1971, when obtaining delivered pricing regulations, the wholesalers made sure delivery could be made only at the wholesaler's dock or the retailer's selling premises. In 1984, the wholesalers achieved an explicit ban against warehousing by retailers because they "wanted to make certain large chain stores could not set up their own warehouse and distribution systems for their respective stores." In 1995, Washington wineries petitioned for the ability to ship their own wine from bonded warehouses directly to retailers (in essence giving retailers a warehousing option). The wholesalers objected. The LCB told the Wine Institute and the WBWWA to get together and reach an agreement. An agreement was struck limiting wineries to shipping no more than 2,000 cases a year to all retailers in the aggregate, and the LCB rubber-stamped it.

Finally, the draft should note that Washington lawmakers did not believe that "loss of control" was a reason to prevent thousands of out-of-state wineries from shipping wine directly to Washington citizens by common carrier— there is far less "control" risk presented by a dozen or two retailer warehouses distributing beer and wine to licensed retail locations.

Thank your for your consideration.

Sincerely yours

A handwritten signature in black ink that reads "John McKay /JS". The signature is stylized and written in a cursive-like font.

John McKay  
Senior Vice President

Encl.



July 28, 2006

Nate Ford  
c/o Sterling Associates, LLP  
4820 Yelm Highway SE, Suite B - PMB 148  
Lacey, WA 98503

Dear Mr. Ford:

We have been following the work of the Task Force closely and appreciate your hard work in attempting to fulfill the legislative mandate. The mandate calls for a fundamental re-examination of the tenets of the state's beer and wine policy – the objective is to move beyond rhetoric and substitute factual and economic analysis. Some of the work of the Task Force has moved toward this objective, but we are concerned that the legitimacy of these efforts has been placed at risk by portions of the recent draft paper on sales and distribution.

Initially, we note a lack of transparency concerning the role of the Liquor Control Board and staff in the preparation of the draft paper. It appears that their role has been substantial. The legislative mandate, however, creates no such role for the LCB. Rather, the mandate calls for the LCB merely to "convene" the Task Force – not to have a role greater than any other participant in creating the recommendations of the task force.

In addition, we recognize that the work of the Task Force is proceeding independent of the related federal lawsuit. However, the objectives cannot be reached by ignoring what happened in the courtroom earlier this year.

The draft paper repeats the assertions of the LCB and presents them as fact, sometimes without even attributing the assertions to the LCB. Generally those assertions are not accompanied by any empirical or other evidence. There is no reference to the fact that these assertions were wholly rejected after a long, objective and detailed examination by the federal court. For the LCB assertions to be put forward without noting the specific conclusions of the federal court is not only misleading, but harmful to the entire process. How can you expect members of the public and stakeholders to believe in the integrity of our process when they see such an incomplete presentation?

I will draw your attention to a few examples: the summary asserts that the "direct and indirect pricing regulations" are "designed, in part, to increase the cost of the product, based on the assumption that price influences consumption . . . and lower consumption in general limits the

misuse of alcohol.”<sup>1</sup> No evidence is cited to support this assertion about the origins of the regulations, and there is none. To the contrary, the federal court found: “Washington does not seek to promote ‘temperance’ by promoting abstention or by reducing overall consumption of beer and wine. Indeed, the state actively promotes its domestic beer and wine industries and seeks to serve overall lawful demand for beer and wine.” Court Ruling at 8 ¶ 11. The court further found that there “is no persuasive evidence that the purpose of any of the challenged restraints was to promote temperance by raising average beer and wine prices.” Page 9 ¶ 16. To the contrary, the court found that the state’s policies “would appear to increase consumption by making it less expensive for consumers to obtain beer and wine at the most convenient and easily accessible locations.” ¶ 15 (emphasis added).

It is insufficient for you to refer to the court’s ruling with the bare statement that the court invalidated the restrictions without including the court’s finding that the justifications proffered by the LCB were invalid.

The draft is also misleading in presenting the LCB’s arguments about why the post and hold system is related to legitimate enforcement objectives. The federal court found that “the state could enforce its below-cost sales law without requiring posting of prices. Most obviously, the state could simply require suppliers and distributors to keep all purchase and sale records on site for inspection by the LCB.” Page 12 ¶ 27 (emphasis added).

The analysis concerning the “level playing field” is also wanting. You repeat the LCB assertion that “without a level playing field, there is greater incentive for the retailer with higher costs to go outside the system to buy the product cheaper.” Again, there is no evidence presented to support this speculation. The federal court found that there is no “persuasive evidence that smaller or more remote retailers would be unable to survive economically without the challenged restraints or that they would otherwise be unable to purchase or profitably sell beer or wine.” Page 13 ¶ 31. The court also found that there is “no persuasive evidence that the challenged restraints play an appreciable role in raising revenue for the state or in ensuring efficient collection of taxes.” Page 14 ¶ 33.

The foregoing is not an exhaustive list of similar references, but illustrative of the issue that causes us great concern. We will seek to supplement the record of the Task Force with all the exhibits and testimony from the federal court trial so that any interested party can have access to the fully contested process that tested (and rejected) the LCB’s assumptions rather than just repeating them.

The LCB and the distributors insisted on a trial that caused the expenditure of millions of dollars in public and private funds and consumed countless hours of the federal judiciary. The LCB cannot pretend now that the results of the trial simply do not exist; nor should this Task Force be used as a forum to re-try the case, which featured the best expert testimony the LCB and the

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<sup>1</sup> Later it is said that prices are only “presumably higher.” Draft at p. 4. Can the LCB have it both ways?

distributors could offer. The truth is that there is no continuing need (if there ever was one) for the post and hold system. We note that the draft paper quotes at length the "intent" section of the post and hold regulations added in 1995 (p. 12). You fail to note that this section was proposed by the distributors' trade association. Court Ruling at 7 ¶ 7.

Finally, there are other relevant questions that the Task Force should consider. To date the LCB has been unable to answer these questions:

Has the LCB sought to track pricing and compare it to consumption or abuse patterns in Washington to see if there is any relationship between pricing and consumption or abuse?

If the LCB is concerned about the impact of price upon consumption, why has it made no effort to monitor, much less control, price at the retail level, where consumer purchaser habits could be influenced?

How does the post and hold system create uniformity, in that it allows different distributors to sell the same item at different prices?

If general federal and state laws protecting competition are sufficient for every industry other than the beer and wine industry, why are special rules and regulations relating to competition necessary for beer and wine? For example, the federal Robinson Patman law prohibits discrimination in pricing when it adversely affects competition. Why is this insufficient to secure any "level playing field" that might be deemed important?

Why is there vibrant competition, among large and small participants, in all sectors of the Washington economy that are not subject to "post and hold" requirements, and so little competition in the distribution of beer and wine, which is subject to these requirements?

Sincerely,

A handwritten signature in black ink that reads "Joel Benoliel". The signature is written in a cursive, slightly stylized font. The first name "Joel" is written with a large, looped 'J' and the last name "Benoliel" follows in a similar cursive style.

Joel Benoliel  
Senior Vice President and Chief Legal Officer